Office-Supreme Court, U.S.
FILED
JUL 18 1985
ALEXANDER L. STEVAS,
CLERK

No. 84-1076

IN THE

Supreme Court of the United States

OCTOBER TERM, 1984

TRANSCONTINENTAL GAS PIPE LINE CORPORATION,
Appellant,

v.

THE STATE OIL AND GAS BOARD OF MISSISSIPPI and COASTAL EXPLORATION, INC., *et al.*,
Appellees.

On Appeal from the Supreme Court of Mississippi

BRIEF FOR THE APPELLEE COASTAL EXPLORATION, INC.

GLENN GATES TAYLOR
(Counsel of Record)
COPELAND, COOK, TAYLOR & BUSH
Suite 112 Capital Towers
Post Office Drawer 2132
Jackson, Mississippi 39225
(601) 354-0123

KENNETH I. FRANKS
JAMES RUSSELL TUCKER
HEIDELBERG, WOODLIFF & FRANKS
Suite 1400 Capital Towers
Jackson, Mississippi 39201
(601) 948-3800

Attorneys for Coastal Exploration, Inc.

July 19, 1985

PRESS OF BYRON S. ADAMS, WASHINGTON, D.C. (202) 347-8203

BEST AVAILABLE COPY

QUESTIONS PRESENTED

1. *The Preemption Question:* Do the Natural Gas Act of 1938 (NGA) and the Federal Energy Regulatory Commission's (FERC) jurisdiction under § 1(b) of the NGA apply to the "first sale" of gas which has been determined to be deregulated natural gas under Section 107 (c)(1) of the Natural Gas Policy Act of 1978 (NGPA)?

2. *The Commerce Clause Question:* Does the requirement that an interstate gas purchaser must offer to take federally-deregulated gas ratably from the wells which produce from a gas pool, and, in the absence of an agreement as to price, must offer to pay the non-contract owners in the pool a "market price" for their gas constitute a burden on interstate commerce? If so, is the burden excessive in relation to the putative local benefits?

TABLE OF CONTENTS

Page

QUESTIONS PRESENTED i

TABLE OF CONTENTS ii

TABLE OF AUTHORITIES iv

STATEMENT OF THE CASE 1

1. The NGA 2
2. The NGPA 4
3. The Interests of the State in Requiring the Ratable Take of Gas From a Pool 6
4. The Controversy Between Coastal and Transco. 8
5. What the State Has Required of Transco 14
6. What the State Has Not Required of Transco . 15

SUMMARY OF THE ARGUMENT 16

ARGUMENT 18

I. MISSISSIPPI'S RATABLE TAKE REQUIREMENT IS NOT PREEMPTED 18

1. There Is No Express Preemption 19
2. There Is No Implied Preemption 20

Peerless 22

Phillips 23

Northern Natural 24

The NGPA 25

Why Did Congress Include Section 601 in the NGPA? 26

TABLE OF CONTENTS continued

Page

Section 601(a)(1) 29

Analysis of Section 601 32

3. There Is No Conflict Between Mississippi's Ratable Take Requirement and the NGA/NGPA .. 36

II. MISSISSIPPI'S RATABLE TAKE REQUIREMENT DOES NOT VIOLATE THE COMMERCE CLAUSE 41

1. The Legitimate State Interests Supporting the Ratable Take Requirement 43

2. The Ratable Take Requirement Applies Evenhandedly 43

3. Transco's Claim of Constitutional Regulatory Alternatives 46

CONCLUSION 50

TABLE OF AUTHORITIES

CASES: Page

Arkansas Electric Cooperative Corp. v. *Arkansas Public Commission*, —— U.S. at ——, 103 S.Ct. at 19160 ..... 40, 43

Arkansas Electric Cooperative Corp. v. *Arkansas Public Service Commission*, 461 U.S. 375 (1983) .. *passim*

Auto Transist Co. v. *Brady*, 430 U.S. 274, 288-89 (1977)

Champlin Refining Co. v. *Corporation Commission*, 286 U.S. 210 (1932) 46

Cities Service Co. v. *FEA*, 529 F.2d 1016, 1027 (T.E. C.A. 1975) 24

Cities Service Gas Co. v. *Peerless Oil & Gas Co.*, 340 U.S. 179 (1950) ..... *passim*

Chevron Chemical Co. v. *Castle*, 641 F.2d 104, 116 (3rd Cir. 1981) 24

Commonwealth Edison v. *Montana*, 453 U.S. 609, 624-29 (1981) 43

Complete Auto Transit Co. v. *Brady*, 430 U.S. 274 (1977) 43

Conoco, Inc. v. *FERC*, 622 F.2d 796 (5th Cir. 1980) .. 34

Energy Reserves Group, Inc. v. *Kansas Power & Light Co.*, 459 U.S. 400 (1983) 20, 24, 39

Exxon Corp. v. *Eagerton*, 103 S.Ct. 2296 (1983) 38, 39

Exxon Corp. v. *Governor of Maryland*, 437 U.S. 117, 127-29 (1978) 43

Hayfield Northern Railroad Co., Inc. v. *Chicago and North Western Transportation Co.*, —— U.S. ——, 104 S.Ct. 2610, 2614 (1984) 20

Hillsborough County v. *Automated Medical Laboratories, Inc.*, 53 L.W. 4612 (June 4, 1985) 39

TABLE OF AUTHORITIES continued

Page

H. P. Hood & Sons, Inc. v. *Dumond*, 336 U.S. 525 (1949) 49

Maryland v. *Louisiana*, 451 U.S. 725, 101 S.Ct. 2114 (1981) 38, 39

Metropolitan Life Insurance Co. v. *Commonwealth*, 53 L.W. 4616 (June 4, 1985) 39

Michigan Canners and Freezer Association, Inc. v. *Agriculture Marketing and Bargaining Board*, —— U.S. ——, 104 S.Ct. 2518 (1984) 18-19

Mid-Louisiana Gas Co. v. *FERC*, 664 F.2d 530, 533 (5th Cir. 1982) 27, 28

Minnesota v. *Cloverleaf Creamery Co.*, 449 U.S. 456, 471-73 (1981) 43

Missouri v. *Kansas Gas Co.*, 265 U.S. 298 (1924) 42

Northern Natural Gas Corp. v. *State Corporation Commission*, 372 U.S. 84 (1963) ..... *passim*

Pacific Gas & Electric Co. v. *State Energy Resources Conservation & Development Commission*, 461 U.S. 190 (1983) ..... *passim*

Pennzoil Co. v. *FERC*, 645 F.2d at 360 (5th Cir. 1981) ..... *passim*

Phillips Petroleum Co. v. *Oklahoma*, 340 U.S. 190 (1950) 22

Phillips Petroleum Co. v. *Wisconsin*, 347 U.S. 672 (1954) 3, 22, 23, 24

Pike v. *Bruce Church, Inc.*, 397 U.S. 137, 142 (1970).. 17, 41, 44

Public Service Commission v. *Mid-Louisiana Gas Co.*, 463 U.S. 319 (1983) 3, 25

TABLE OF AUTHORITIES continued

Page

Public Utilities Commission v. *Attleboro Steam and Electric Co.*, 273 U.S. 83 (1927) 42

Public Utilities Commission v. *Landon*, 249 U.S. 236 (1919) 42

Reeves, Inc. v. *Stake*, 447 U.S. 429, 443-47 (1980) 43

Silkwood v. *Kerr-McGee Corp.*, —— U.S. ——, 104 S.Ct. 615, 621 (1984) 19

Sporhase v. *Nebraska*, 458 U.S. 941, n. 16 (1982) 24

Tenneco, Inc. v. *Sutton*, 530 F.Supp. 411, 417 (M.D. La. 1981) ..... *passim*

OTHER AUTHORITIES:

Mississippi Oil & Gas Production Report (March 1985) 7

18 C.F.R. Sections 154.39 and 154.103 27

124 Cong. Rec. 29099-29109 (9-13-78) 20

124 Cong. Rec. 30011-30035 (9-19-78) 20

"Curtis/Jackson Letter" of September 8, 1978 .... 29, 32

4 Energy Law Journal 251 (1983), *Note: Has The Supreme Court Pulled The Rug From Under The FERC's Electric And Natural Gas Regulation?* .. 3

4 Energy Law Journal 255 (1983), *Note: The Role of the States in Energy Regulation* 3

Federal Programs Advisory Service [FPAS] § 601: 220, pg. 3 ..... 27, 32

Miss. Code Ann. § 53-1-3(k)(1)-(3) (S. 1984) 9

Moody, *The Natural Gas Policy Act of 1978: Analysis and Overview*, 25th Annual Rocky Mtn. Mineral Law Institute 2-1 at 2-89 (1979) 5

TABLE OF AUTHORITIES continued

Page

Moring, *A Quiet Revolution? The FERC Yields Pipeline Jurisdiction to the States and Courts*, Public Utilities Fortnightly at 36. (11-22-84) 41

Section 1(b) of the Natural Gas Act (NGA), 15 U.S.C. § 717(a) ..... *passim*

NPGA Section 107(c)(1) ..... *passim*

NGPA Sections 503 and 602, 15 U.S.C. §§ 3413 and 3432 20

NGPA § 601(a)(1)(A) & (B), 15 U.S.C. § 3431(a)(1)(A) & (B) ..... *passim*

Pierce, *Natural Gas Regulation, Deregulation and Contracts*, 68 Va. L. Rev. 63, 65-72, 86-89 (1982) 4, 5

Pierce, *Reconsidering The Roles of Regulation And Competition In the Natural Gas Industry*, 97 Harv. L. Rev. 345 (1983) 3, 5

Williams, *Federal Preemption of State Conservation Laws After the Natural Gas Policy Act: A Preliminary Look*, 56 Univ. of Colo. L. Rev. 901 (1985) 4, 28, 38

IN THE

Supreme Court of the United States

OCTOBER TERM, 1984

No. 84-1076

TRANSCONTINENTAL GAS PIPE LINE CORPORATION,
Appellant,

v.

THE STATE OIL AND GAS BOARD OF MISSISSIPPI and COASTAL EXPLORATION, INC., *et al.*,
Appellees.

On Appeal from the Supreme Court of Mississippi

BRIEF FOR THE APPELLEE COASTAL EXPLORATION, INC.

STATEMENT OF THE CASE

The State of Mississippi has attached a ratable take requirement to Transco's takes of federally-deregulated gas from a gas pool in Mississippi. In 1950, this Court held that a state ratable take order entered against an interstate pipeline purchaser of gas was constitutional and did not violate the Commerce Clause. *Cities Service Gas Co.* v. *Peerless Oil & Gas Co.*, 340 U.S. 179 (1950). In 1963, after having interpreted the Natural Gas Act of 1938 (NGA) as applying to producers' sales of gas to interstate purchasers for resale, this Court held that a ratable take order was preempted by the Federal Power Commission's (FPC) jurisdiction over wellhead sales of gas in interstate commerce, because of what the Court

then viewed as a pervasive scheme of federal regulation under the NGA. *Northern Natural Gas Corp.* v. *State Corporation Commission,* 372 U.S. 84 (1963).

In order to bring about the beginning of the end of the national crisis of shortages of gas in the interstate market, shortages which had been caused by the practical effect of the NGA, in 1978 Congress passed the NGPA, "a fundamental change in regulatory outlook." The NGPA exempts the wellhead sale and purchase of federally-deregulated natural gas from the jurisdictional provisions of the NGA which *Northern Natural* held preempted the state ratable take order in that case.

Thus, the States, once again, are free to attach a reasonable ratable take requirement to an interstate pipeline's takes of federally-deregulated natural gas, and Mississippi's simple ratable take requirement is neither preempted nor does it violate the Commerce Clause. *Transcontinental Gas Pipe Line Corporation* v. *State Oil & Gas Board,* 457 So.2d 1298 (Miss. 1984) ("Transco").

Why is this now the case? A review of regulatory history and the facts of the controversy between Coastal and Transco is in order.

1.

The NGA

Prior to November 1978, there *was* a pervasive scheme of federal regulation of first sales, resales and transportation of natural gas in the interstate market. This pervasive scheme of federal regulation was established under Section 1(b) of the Natural Gas Act (NGA), 15 U.S.C. § 717(a), which regulated, *inter alia,* the "sale in interstate commerce of natural gas for resale for ultimate public consumption" and "natural gas companies engaged in such transportation or sale." The NGA was designed to fill what was then perceived as a "gap" between what the

states could not regulate and what the federal government had not yet regulated,[1] and had the primary objective of "protection of consumers from exploitation at the hands of natural-gas companies."[2] These were the same type of considerations which also led to passage of the Federal Power Act regulating sales of electricity in interstate commerce.

Under its NGA jurisdiction, the Federal Power Commission (FPC) eventually came to regulate every facet of the sale, purchase and transportation of natural gas in the interstate market, beginning with the wellhead or first sale. A producer could not sell or deliver, and a purchaser could not buy or introduce natural gas into the interstate market without FPC approval. The price charged and paid for natural gas had to be "just and reasonable" as determined by the FPC. Sales could not be terminated without FPC approval. The scheme of federal regulation was truly pervasive and comprehensive.[3] The country, however, paid a heavy price for this pervasive scheme.

This pervasive scheme of federal regulation under the NGA resulted in artifically low NGA-mandated just and reasonable wellhead prices which were below the true market value of natural gas. These low prices, coupled with the non-price federal regulations attending any attempt to sell or cease to sell natural gas in the interstate market, reduced or altogether eliminated the incentives

---

[1] *See Note: Has The Supreme Court Pulled The Rug From Under The FERC's Electric And Natural Gas Regulation?* 4 Energy Law Journal 251 (1983); *Note: The Role of the States In Energy Regulation,* 4 Energy Law Journal 255 (1983).

[2] *Phillips Petroleum Co.* v. *Wisconsin,* 347 U.S. 672 (1954). *See* Pierce, *Reconsidering The Roles of Regulation And Competition In the Natural Gas Industry,* 97 Harv. L. Rev. 345 (1983).

[3] *See, e.g.,* discussions in *Tenneco, Inc.* v. *Sutton,* 530 F.Supp. 411, 417 (M.D. La. 1981); *Public Service Commission* v. *Mid-Louisiana Gas Co.,* 463 U.S. 319 (1983).

for producers to discover new gas reserves and sell that gas in the interstate market. Instead, as the years passed by producers sold more and more of their new gas into the federally-unregulated intrastate markets where the producers could sell their gas at market prices. Consequently, total reserves and deliverability dedicated to the interstate market declined while the interstate demand for gas increased. By the mid-1970s, this dual market system resulted in severe shortages of natural gas in the interstate market, shortages which have been described as a "national crisis," while at the same time the intrastate markets enjoyed a surplus of natural gas. By the mid-1970s, there was a general consensus that the pervasive scheme of federal regulation under the NGA had not worked to provide consumers of interstate gas with a dependable supply of natural gas. With gas deliveries in the interstate market being reduced or altogether curtailed to industries, electric utilities and schools, it became apparent that the pervasive scheme of federal regulation under the NGA had nurtured an economic disaster of national proportions.[4] Simply put, the pervasive scheme of federal regulation had not worked.

2.

The NGPA

The nation's recovery from that abysmal situation began in November 1978 with passage of the NGPA, correctly described as "a fundamental change in regulatory outlook."[5] This regulate-to-deregulate plan eliminated the

---

[4] *See, e.g.,* discussions in *Tenneco, Inc.* v. *Sutton, supra,* 530 F. Supp. at 420-21; *Pennzoil Co.* v. *FERC,* 645 F.2d 360 (5th Cir. 1981); Pierce, *Natural Gas Regulation, Deregulation and Contracts,* 68 Va. L. Rev. 63, 65-72 (1982).

[5] *Pennzoil Co.* v. *FERC, supra,* 645 F.2d at 378. *See* Williams, *Federal Preemption of State Conservation Laws After the Natural Gas Policy Act: A Preliminary Look,* 56 Univ. of Colo. L. Rev. 901 (1985) [herein cited as "Williams"].

difference between the interstate and intrastate markets, and instituted a comprehensive plan of federal deregulation under which some gas was immediately deregulated, other gas was gradually deregulated, regulated prices were allowed to rise, and the "first sale" transaction involving new gas was exempted from FERC's jurisdiction under § 1(b) of the NGA, all in order to provide producers and pipeline purchasers of gas with the degree of freedom from federal regulation and the price incentives necessary to encourage producers to discover new gas reserves and sell that gas in the interstate market, and thereby end the national crisis of shortages of natural gas in the interstate market.[6]

The NGPA creates various incentive categories of natural gas in order to encourage producers to find new gas reserves and sell their gas in the interstate market. One of these categories is "high-cost natural gas" under Section 107(c)(1) of the NGPA, being gas which is found at depths below 15,000 feet. The "high-cost" terminology does not refer to the sales price of the gas, but to the significant costs and risks incurred to find and produce gas found at great depths. Consequently, as an incentive to discover and produce this type of gas, this type of gas would be completely price deregulated as of November 1, 1979 and, as in the case of other new natural gas, the first sale and purchase of this deep gas would never be subject to the FERC's jurisdiction under § 1(b) of the NGA. *See* NGPA § 601(a)(1)(A) & (B), 15 U.S.C. § 3431(a)(1)(A) & (B).

---

[6] *See, e.g.*, Moody, *The Natural Gas Policy Act of 1978: Analysis and Overview*, 25th Annual Rocky Mtn. Mineral Law Institute 2-1 at 2-89 (1979); Pierce, *Reconsidering The Roles of Regulation And Competition In the Natural Gas Industry*, 97 Harv. L. Rev. 345 (1983); Pierce, *Natural Gas Regulation, Deregulation and Contracts*, 68 Va. L. Rev. 63, 86-89 (1982); *Pennzoil Co.* v. *FERC*, *supra*, 645 F.2d at 367, n. 13; Williams, *supra*.

The price and non-price incentives provided by the NGPA caused a literal stampede by producers to drill more wells to deeper depths to discover gas in deep gas pools, pools which are typically characterized by high deliverability and substantial reserves. Interstate pipeline purchasers of gas, freed from the constraints the NGA imposed on their ability to purchase new gas and pay competitive market prices, responded with fierce competition to bid up and buy reserves of new gas. It was against the background of that national crisis of gas shortages in the interstate market and the passage of the NGPA that the deep gas pools in the Greens Creek and East Morgantown Fields in Jefferson Davis and Marion Counties, Mississippi were developed, Transco began taking natural gas from those fields, the present controversy developed between Coastal and Transco, and the State required Transco to take gas ratably.

The legitimate state interests which support the ratable take requirement at issue are rooted in the manner in which gas must be taken from a gas pool so that the coequal and correlative rights of the owners are protected and each owner is afforded the opportunity to recover his just and equitable share of gas and is treated fairly. These interests are evident from a review of the realities of producing a gas pool, and the need for each owner in a pool to have the opportunity to sell his ratable share of production on a current basis.

3.

The Interests of the State in Requiring the Ratable Take of Gas From a Pool

A typical gas field is underlain by one or more gas pools and usually is developed by a few operators, as few as one or two. An operator usually owns one of the largest interests in the wells it operates. The operator oversees drilling, completion and operation of the wells and under-

takes to obtain a purchaser for the oil and gas produced. In negotiating to sell the production, the operator's bargaining position is substantial because the other owners in the well generally will sell their gas to the purchaser selected by the operator.

A pipeline purchaser of gas generally attempts to buy all of the gas to be produced from a given field in order to justify the significant capital investment required to build a pipeline connection, and to obtain a long term supply of gas. While "split-stream" sales of gas to more than one purchaser can occur, a typical gas field is characterized by a single pipeline purchaser who buys gas for resale. While there may be a choice of pipeline purchasers at the inception, once a purchaser is selected and its facilities are connected to the wells, that purchaser then provides what is the only "market" for the gas produced from the wells.[1] For all practical purposes, the purchaser monopolizes the market in the field. This monopsony condition can prevail even though the pipeline has less than fifty percent of all of the owners in the wells under written contracts.

The custom and practice in the industry has been for the owners of small interests in a gas unit to sell their gas to their operator's purchaser on the same terms and conditions as the operator sells its gas. J.A. 30-31, 76, 123-124, 133, 155, 231-232. In Mississippi, this practice has developed in part because Mississippi's law of co-tenancy can result in there being numerous owners in a given gas unit. J.A. 123-124. Thus, the practice has been for the pipeline purchaser to contract with the operator and other owners of substantial interests, and, in order to avoid the administrative tasks of contracting directly with all of the many

---

[1] There are 198 pools in the State of Mississippi, but only 36 gas purchasers. Approximately 9 of the purchasers are interstate pipeline purchasers. *See* Mississippi Oil & Gas Production Report (March 1985) at page 96.

owners of small interests, to buy those owners' share of gas production without a written contract but on the same terms and conditions as are provided for in the operator's contract. Historically, therefore, it has generally been the case that every owner who has wanted to sell his gas has had access to the market at the wellhead.

There are, however, reasons more important than mere cash flow for all owners in a pool to have the opportunity to produce their gas ratably and sell it on a current basis. These reasons include the prevention of drainage between competing wells and the recovery of each owner's just and equitable share of gas in the pool. J.A. 13-15, 77-78.

A gas pool, particularly a deep gas pool, is under tremendous pressure. Consequently, the gas in a pool will migrate to an area of reduced pressure, such as the borehole of a gas well. Theoretically, one well completed into any point of a pressure depletion pool will drain the entire pool, and not just that part of the pool which lies beneath the geographical limits of the well's production unit. Thus, the wells which produce from a common pool compete with one another to obtain their respective just and equitable shares of gas in the pool. In Mississippi, the recovery of those respective shares is based on the ratable take of the respective allowables of the wells.

In Mississippi a well's "allowable" is the maximum rate of production at which the well is allowed to be produced, sometimes referred to as its "maximum efficient rate of flow." Owing to the different points at which the wells in a pool are completed, and differing sand thicknesses, permeabilities, and porosities, the wells completed into a pool usually do not have identical allowables. Some wells simply are capable of producing more gas than others. While allowables may vary from well to well, the wells recover their respective just and equitable shares of gas from the pool by ratably taking gas, that is, by taking gas from all of the wells at the same percentage of their respective allowables.

Without the ratable taking of gas from a pool, some wells (and owners) would drain offsetting units and recover more than their just and equitable share of gas in the pool, resulting in prohibited "waste" and the abuse of the coequal and correlative rights of the owners in the pool. Unratable takes also create unnatural drainage patterns, the premature dissipation of reservoir energy, and damage to the productive capability of a pool. *See* Miss. Code Ann. § 53-1-3(k)(1)-(3) (S. 1984). A ratable requirement protects against these "evils." The requirement also, quite literally, allows each owner the opportunity to recover his just and equitable share of production on a *current* basis, an important factor indeed.

As production continues from a gas pool, the reservoir pressure declines. With production and the passage of time, it becomes more difficult, expensive and risky to recover the remaining gas in a pool. Typically, compressors are added and enhanced recovery techniques are necessary in order to continue to produce gas from the pool. Eventually, the pressure of the pool will decline to such an extent that some gas, though remaining, will never be recovered. Thus, the owner of a 1% interest in a gas pool cannot wait until 99% of the gas in the pool has been recovered and still have a fair opportunity to recover his just and equitable share of gas. Consequently, if the owner of a small interest is to have more than an illusory right to recover his just and equitable share of gas in a pool, that owner must be allowed to recover his gas on a current basis, along with his operator. An owner, however, cannot recover his gas on a current basis unless he has the *opportunity* to sell his gas at the wellhead on a current basis.

Once produced and brought to the surface, gas, unlike oil, cannot be practically tanked, stored or warehoused by a producer; it must be sold immediately. Thus, the opportunity to produce gas is inextricably intertwined with the opportunity to sell gas at the wellhead; one cannot exist without the other. To condition a producer's right

to produce his gas ratably on his having a market, but then deny him access to the market at the wellhead, is to treat him unfairly and defeat his right to recover his just and equitable share. For this reason, an owner's opportunity to sell gas at the wellhead along with the other taking owners is the key to ratable taking and the prevention of drainage.

This need for fair treatment is underscored in the case of the owner of a small interest in a gas unit. Rarely, if ever, is a pipeline purchaser willing to build a pipeline or gathering system to buy a mere one or two percent of the gas produced by a well. Practically, the owner of a small interest has the Hobson's choice of selling his gas to the operator's purchaser, or to no one at all, inasmuch as the gas will be drained if not produced and sold.

These are the facts of life in a gas pool. Unratable takes of gas caused by a purchaser's refusal to buy gas from some owners is fundamentally unfair and deals an economic death-blow to the small producer who must have the opportunity to recover and sell his just and equitable share of gas along with his co-owners in order to pay his royalty owners, pay his share of drilling and completion costs, compete with his operator and other oil companies for new drilling rights, and drill new wells.

Transco's refusal to buy Coastal's ratable share of gas produced from the Harper Sand Gas Pool, and Transco's resulting unratable takes of gas from that pool, prompted the ratable take requirement at issue.

4.

The Controversy Between Coastal and Transco

In 1982, six (6) wells produced from the Harper Sand Gas Pool which underlies the south end of the Greens Creek Field and the north end of the East Morgantown Field in Jefferson Davis and Marion Counties, Mississippi. J.A. 6-9.

Getty Oil operated three (3) of the wells, Tomlinson Interests operated one (1), and Florida Exploration Company operated two (2). The State Oil and Gas Board of Mississippi has classified all of the wells as "deep, high-cost" wells under Section 107(c)(1) of the NGPA. Coastal owns a 2½% working interest in one of the Getty-operated wells, and less than a 1% working interest in each of three (3) remaining wells, one operated by Getty, one by Tomlinson and one by Florida. Coastal participated in drilling each of these four (4) wells and has paid its share of drilling, completing and operating costs. J.A. 28-30.

In August 1980, Getty entered into a gas purchase contract with Transco. That contract resulted in a price at the wellhead of $7.907 per MMBTU. At that point in time, the industry practice was for a purchaser to contract with the owners of substantial interests in a well and with the operator of the well, and then to purchase the gas of the remaining owners of small interests on the same terms and conditions as provided for in the operator's contract. J.A. 26, 30-31, 76, 123-124, 133, 155, 231, 232. The present case mirrors that practice.

Transco never offered Coastal the same contract which Transco offered Getty. J.A. 30. After learning that Getty had entered into a contract with Transco, Coastal wrote and asked Transco for a copy of the contract, but Transco refused to provide a copy. Coastal then obtained a copy of the contract from Getty. Coastal then agreed that Getty would sell all of Coastal's gas to Transco on the same terms and conditions as Getty sold its gas to Transco. J.A. 78-83.

First production from the pool began in April 1981, with Transco taking all of the gas produced, including Coastal's gas. As other wells were completed into the pool, this same procedure was followed. Transco knew it was purchasing gas from owners like Coastal with whom it did not have a written contract, the so-called "non-contract owners." J.A. 133, 230.

This situation continued until May 1982 when Transco notified Getty and Tomlinson that effective June 1, 1982 (later changed to July 1, 1982) Transco would no longer take or purchase the gas of the non-contract owners. However, because of certain provisions of the Florida-Transco gas contract, Transco would continue to purchase non-contract owners' gas produced from the Florida-operated wells and pay those owners the same price Transco paid Florida. J.A. 39-42.

After receiving this notice from Transco, Getty and Tomlinson notified Coastal that they, as operators, would not produce Coastal's share of gas from the wells they operated unless Coastal obtained its own gas purchase contract. Being unable to secure another purchaser, Coastal asked Transco to be allowed to ratify Getty's 1980 contract. Transco refused, unless Coastal would agree to amend the pricing provisions to add a "market-out clause," a clause which would allow Transco to reduce the purchase price if the price became "uneconomic." Coastal rejected this offer, whereupon Transco refused to take any of Coastal's gas at *any* price.

Effective July 1, 1982, as to the Getty-operated wells, and effective August 19, 1982, as to the Tomlinson-operated well, Transco ceased to take gas attributable to the interests of the non-contract owners until and unless an owner accepted Transco's market-out offer. As a result, Transco's takes of gas and the rates of production from the common pool by these wells were "cutback" to below the maximum efficient rate of flow of the wells. Thereafter, for all practical purposes, the wells produced only and Transco purchased only a rate of production equal to the operators' and other contract owners' interests in the maximum efficient rate of flow from the wells.

The situation with the two (2) Florida-operated wells was different. Transco continued to purchase the non-contract owners' gas produced from these two (2) wells on

the same terms and conditions and at the same price which Transco paid for Florida's gas, $8,4066 per MMBTU. Thus, while Transco cut back its takes of gas from the Getty-operated and Tomlinson-operated wells to below their respective allowables, Transco continued to take gas from the two Florida-operated wells at their respective allowables.

On July 29, 1982, Coastal filed its Petition with the State Oil and Gas Board asking that Transco be prohibited from committing "waste" by taking gas unratably from the wells, and be required to comply with Statewide Rule 48* by ratably taking gas from the wells producing from the pool and purchasing without discrimination in favor of the operators against Coastal.

At the conclusion of a three-day trial, the Board ruled in favor of Coastal and the other intervening producers, and directed Transco to comply with Statewide Rule 48. In relevant part, the Board ordered that "in the event it so chooses and elects to take and purchase gas from said common pool, Transco shall ratably take and purchase without discrimination in favor of the operators, Getty and Tomlinson against Coastal, the Fairchilds and Inexco."

The Mississippi Supreme Court held that the state ratable take order was not preempted and did not violate the Commerce Clause. The Court, however, modified the order as a matter of state law, holding:

> "We affirm so much of the order of the State Oil and Gas Board as requires Transco, if it takes at all from a common source of supply, to take ratably; that is, Transco is required to offer in good faith to purchase from every one of the various producing interests in the common source of supply the same percentage of

---

* "Each person now or hereafter engaged in the business of purchasing oil or gas from owners, operators, or producers shall purchase without discrimination in favor of one owner, operator or producer against another in the same common source of supply."

> those producers' gas as it purchases from that producer the highest percentage of whose interest Transco takes. • • •
>
> A caveat need be added: We do not hold that a pipeline purchaser may offer any terms, take-it-or-leave-it, and meet its Rule 48 obligations. Offering a working interest owner a choice between a substantially below market price or otherwise wholly unreasonable terms, on the one hand, and drainage on the other, is simply not a ratable taking and is a violation of Rule 48. To comply with this Rule 48 obligations the pipeline must offer in good faith reasonable terms, including a reasonable price, determined by reference to prevailing market conditions and other appropriate economic considerations.
>
> Of course, nothing in Rule 48 requires that Transco take any gas from a given source of supply. If it takes at all, however, it must take, or in good faith offer to take, ratably."

Transco, supra, 457 So.2d at 1327, 1331.

5.

What the State Has Required of Transco

The ratable take requirement at issue is intended to prevent reasonably avoidable drainage between gas units, to afford each "owner" in a pool the opportunity to recover his just and equitable share of gas from a pool, to make that opportunity meaningful by giving each owner access to the market which is available at the wellhead, and to treat the owners fairly.

The ratable take requirement is two-fold and is very simple: First, if and when Transco takes federally-deregulated gas from the pool, Transco must offer to take whatever quantities of gas it desires ratably from all of the wells. Second, for the gas of those owners who do not have a written contract with Transco, but who want to

sell their gas, in the absence of an agreement, Transco must offer to pay a "market price."

6.

What the State Has Not Required of Transco

Given the many ridiculous misrepresentations made by Transco and the FERC about what the State supposedly has required of Transco, it is an appropriate time to consider what the State has *not* required.

The State has not required Transco to take more gas than it needs, nor to take the full allowable of any well(s), nor to take the full allowable of any pool, nor to give any producer a contract, nor to pay anyone "take-or-pay-money," nor to pay a fixed price, nor to pay a higher-than-market price, nor to take more expensive gas to the exclusion of less expensive gas, nor to take any gas at all. Thus, the representations that Mississippi has *required* or *forced* production "in excess of market demand," or has required Transco to take "high cost" gas have no basis in fact. They are misrepresentations.

There simply is no state requirement that Transco must take gas in excess of Transco's needs. In any given month or period of time, Transco, judging what its needs are, may take 100% of the pool's allowable, or 1% of the pool's allowable, or no gas at all. Likewise, the State has not required Transco to pay a "high cost" for any gas. For NGPA well category purposes, the gas in question *is* "high-cost natural gas" under § 107, but there is *nothing* "high" about the price Transco must offer to pay for the non-contract owners' gas whenever Transco decides to take gas from the pool. In the absence of an agreement on price, Transco must offer to pay a mere market price. The State has not even attempted to dictate what that price should be. Transco has responded to this requirement by paying the non-contract owners Transco's "market-out" price since December 1982.

SUMMARY OF THE ARGUMENT

1. *The Preemption Question:* Do the NGA and the FERC's jurisdiction under § 1(b) of the NGA apply to the "first sale" of gas which has been determined to be deregulated natural gas under Section 107(c)(1) of the NGPA? No. The answer to that narrow question lies in the clear language of Section 601(a)(1) of the NGPA. Some case history is in order. In *Cities Service Gas Co.* v. *Peerless Oil & Gas Co.*, 340 U.S. 179 (1950) (*"Peerless"*), the Court upheld the constitutionality of a state ratable take/minimum price order entered against an interstate gas purchaser. The Court, however, did not consider the effect of the NGA on the validity of such an order. That effect was considered thirteen (13) years later in *Northern Natural Gas Co.* v. *State Corporation Commission of Kansas*, 372 U.S. 84 (1963), which held invalid a state ratable take order directed against an interstate pipeline company because the State's order invaded the Federal Power Commission's (FPC) *then-existing* exclusive regulatory jurisdiction under Section 1(b) of the NGA, jurisdiction and regulatory authority which, at that point in time, extended to a producer's sale and a pipeline's purchase of natural gas in the interstate market. The NGPA, however, brought about a fundamental change in the pervasive regulatory scheme under the NGA. Specifically, Section 601(a)(1)(A) & (B) of the NGPA provides that the first sale of, *inter alia,* deregulated "high-cost natural gas" is *never* made subject to either Section 1(b) of the NGA or FERC's jurisdiction under Section 1(b). Because the FERC no longer has any statutory authority to regulate the first sale transaction involving that category of natural gas, the statutory reasons for the result in *Northern Natural* no longer exist in the case of that category of gas, and the State, once again, is free to attach a ratable take requirement to that first sale transaction. *Peerless.* Thus, Mississippi's ratable take requirement does not actually or theoretically conflict with either the NGA or the NGPA.

Nor does the requirement frustrate or stand as an obstacle to the purposes and objectives of the NGPA. The principal objective of the NGPA was to make *more* new gas available for sale in the interstate market at market prices. Mississipi's requirement fits congruently with that objective by affording all of the owners of federally-deregulated gas in a pool the opportunity to deliver their ratable share of a purchaser's gas needs at a market price.

2. *The Commerce Clause Question:* Does the requirement that an interstate gas purchaser must offer to take federally-deregulated gas ratably from the wells which produce from a gas pool and, in the absence of an agreement as to price, must offer to pay the non-contract owners in the pool a market price for their gas constitute a burden on interstate commerce? If so, is the burden excessive in relation to the putative local benefits? No. That precise question was answered thirty-five (35) years ago in *Peerless,* which rejected the claim that a state ratable take order violates the Commerce Clause. *Northern Natural,* decided on narrow statutory grounds, noted that *Peerless* remained good law as to the constitutional challenges to a state ratable take order. *Stare decisis,* however, is not the only reason why the state action at issue does not violate the Commerce Clause. Mississippi's ratable take requirement is an evenhanded measure taken to effectuate legitimate state interests, with any burden on interstate commerce being incidental or minimal. The most that can be said is that, on a purely hypothetical basis there might at *some* point be *some* incidental and as yet undefined effect on interstate commerce but, given the strong legitimate state interests and local benefits sought to be effected by the state requirement, the possibility that an incidental effect might be felt somewhere by someone does not rise to the level of a prohibited "excessive" burden on interstate commerce, if a burden at all. *Peerless, supra; Pike* v. *Bruce Church, Inc.,* 397 U.S. 137, 142 (1970); *Arkansas Electric Cooperative Corp.* v. *Arkansas Public Service*

Commission, 461 U.S. 375 (1983); *Pacific Gas & Electric Co.* v. *State Energy Resources Conservation & Development Commission*, 461 U.S. 190 (1983).

ARGUMENT

I.

MISSISSIPPI'S RATABLE TAKE REQUIREMENT IS NOT PREEMPTED

The Mississippi ratable requirement at issue is not preempted by either the NGA or the NGPA, for at least three (3) reasons. First, the pervasive scheme of federal regulation, which was perceived to exist when *Northern Natural* was decided, no longer exists. Congress has expressly declared that the first sale/purchase of deregulated natural gas is free from federal regulation under both the NGA and the NGPA, and Congress has not prohibited the States from once again regulating what the federal government has ceased to regulate. Second, there is no actual or theoretical conflict between the wellhead transaction affected by the state requirement and the subsequent transportation and resale activities which the FERC regulates on a modified basis. It is possible for Transco to comply with both the state requirement and the applicable federal regulations. Third, the state requirement does not frustrate or stand as an obstacle to the purposes and objectives of the NGPA. The primary objective of the NGPA is to make *more* new gas available to the interstate market and allow producers who sell in interstate commerce the opportunity to receive a fair market price for their new gas. That is what—and all—that the state requirement at issue has effected: An opportunity for the owners in a pool to sell their new gas in interstate commerce at a fair market price.

There are three (3) ways in which state law can be preempted by federal law: First, Congress may explicitly define the extent to which it intends to preempt state law. *Michigan Canners and Freezer Association, Inc.* v. *Agri-*

culture Marketing and Bargaining Board, —— U.S. ——, 104 S.Ct. 2518 (1984). "[A] federal decision to forego regulation in a given area may imply an authoritative federal determination that the area is best left unregulated, and in that event would have as much pre-emptive force as a decision to regulate." *Arkansas Electric Cooperative Corporation* v. *Arkansas Public Commission, supra.* This requires an affirmative statement by Congress that neither the States nor the Federal Government is to regulate an activity or area. *Id; Pacific Gas & Electric Co.* v. *State Energy Resources Conservation and Development Commission, supra.* Second, Congress may indicate an intent to occupy an entire field of regulation, in which case the States must leave all regulatory activities in that area to the federal government. *Michigan Canners, supra.* This requires a showing of a "scheme of federal regulations so pervasive as to make reasonable the inference that Congress left no room to supplement it." *Pacific Gas and Electric Co., supra; Silkwood* v. *Kerr-McGee Corp.,* —— U.S. ——, 104 S.Ct. 615, 621 (1984). Third, if Congress has not displaced state regulation entirely, it may nonetheless preempt state law to the extent that the state law actually conflicts with federal law. Such a conflict arises when compliance with both state and federal laws is possible, or when the state law stands as an obstacle to the accomplishment and execution of the full purposes and objectives of Congress. *Michigan Canners, supra; Silkwood, supra,* 104 S.Ct. at 621.

The state ratable take requirement at issue clears all of these hurdles.

1.

There Is No Express Preemption

Congress has not made an express authoritative determination that federally-deregulated wellhead sales of natural gas are to be left unregulated by the States. The test is not, as Transco suggests, whether Congress has affirma-

tively *granted* the States the authority to regulate these wellhead sales; rather, it is whether Congress has affirmatively declared that these sales are *not* to be regulated by the States. *See Arkansas Electric Cooperative Corporation, supra,* 103 S.Ct. at 1912; *Pacific Gas and Electric Co., supra,* 103 S.Ct. at 1722; *Hayfield Northern Railroad Co., Inc.* v. *Chicago and North Western Transportation Co.,* —— U.S. ——, 104 S.Ct. 2610, 2614 (1984).

Nothing in the language, history or policy of the NGPA suggests such a conclusion.* For example, NGPA Sections 503 and 602, 15 U.S.C. §§ 3413 and 3432, provide express authority for the States to take steps to classify wells and set lower maximum lawful prices. *See Energy Reserves Group, Inc.* v. *Kansas Power & Light Co.,* 459 U.S. 400 (1983). Obviously, Congress contemplated that the States would not be preempted from reasserting a regulatory presence in the area of wellhead sales of federally-deregulated natural gas. Thus, as even the FERC concedes (FERC's Brief at p. 15), there is no language in the NGPA or its legislative history which states that the States may not reasonably regulate what the FERC can no longer regulate. Accordingly, the State is not expressly preempted from acting. *See,* e.g., *Pacific Gas & Electric Co., supra; Hayfield Northern Railroad Co., Inc., supra.*

2.

There Is No Implied Preemption

Preemption may be implied from a pervasive scheme of federal regulation. The NGPA, however, has eliminated whatever pervasive scheme of federal regulation provided the rationale in *Northern Natural* for this Court to invalidate a state ratable take order. There is no actual or theoretical conflict between the wellhead transaction af-

---

* *See, e.g.,* 124 Cong. Rec. 29099-29109 (9-13-78); 124 Cong. Rec. 30011-30035 (9-19-78).

fected by the State, and the subsequent transportation and resale activities which the FERC regulates on a modified basis.

The corresponding section of Transco's brief to which we now respond is a remarkable work of intellectual dishonesty: Transco does not even pause to cite *the* case or discuss *the* statute or mention *the* Congressional conference report which are controlling of the federal preemption issue. The omitted case is *Peerless, supra;* the undiscussed statute is Section 601(a)(1) of the NGPA; and the unmentioned report is *the* "Joint Explanatory Statement of the Committee on Conference" of the Congress which accompanied the NGPA and explained the meaning and intent of § 601(a)(1). The first upheld a very similar ratable take/non-discriminatory purchase order directed against an interstate gas pipeline prior to *Northern Natural;* the second and third make it clear that Congress, by deregulating this gas and providing that a wellhead sale of deregulated gas is no longer subject to FERC's jurisdiction under the NGA, rendered both the rationale and the rule of *Northern Natural* inapplicable to the first sale/purchase of deregulated gas.[10]

How did we come to this point? By two roads. First, down a road of NGA/FERC regulation of the first sale transaction between a producer and an interstate gas purchaser, a comprehensive regulation which resulted in artificially low NGA-mandated "just and reasonable" wellhead prices, low prices which created disincentives for producers to drill for new gas and sell that gas into interstate commerce, a lack of incentive which ultimately led to the severe interstate gas shortages of the mid-1970s,

---

[10] The gas in question is both deregulated gas, meaning that it has been classified as "deep, high-cost gas" under NGPA Section 107(c)(1), and undedicated gas, meaning that it was not committed or dedicated to interstate commerce on the day before the date of enactment of the NGPA. See NGPA Section 601(a)(1).

shortages which have been described as a "national crisis." That is the same road which led to the *Phillips* decision in 1954 and to *Northern Natural* in 1963.

The nation's recovery from that abysmal situation began in 1978 when Congress turned down a second road, a road of NGPA regulation-to-deregulate which eliminated the difference between the interstate and intrastate markets, and provided producers and interstate gas purchasers alike with the degree of freedom from federal regulation and with the price incentives which Congress determined were needed in order to allow the price of gas *to rise* and encourage producers to discover and produce new gas and sell that gas in the interstate market. NGPA Section 601 (a)(1) was the means used to eliminate federal regulation of the first sale and purchase of certain types of natural gas, including the gas at issue. It is the elimination of that federal regulation which has freed the State, once again, to attach a simple ratable take requirement to the first sale and purchase of federally-deregulated gas. The State's authority to make that type of requirement was recognized by this Court thirty-five (35) years ago in *Peerless*.

Peerless

The producer in *Peerless* found itself in virtually the same quandary as did Coastal: The interstate gas purchaser who was buying from the pool first refused to buy Peerless' gas at all, and then offered to buy the gas at a price which was lower than that being paid to other owners in the field. The state conservation commission then entered a ratable take order requiring the purchaser to take gas ratably from the pool and to pay Peerless a fixed minimum price. This Court, in a unanimous decision, rejected challenges to the order made on the grounds of the Due Process, Equal Protection and Commerce Clauses.[11]

---

[11] In a companion case to *Peerless*, *Phillips Petroleum Co.* v. *Oklahoma*, 340 U.S. 190 (1950) the Court upheld a similar minimum price order issued by the Oklahoma Corporation Commission.

In *Peerless,* however, the Court made the cryptic observation that it was not considering the effect the NGA might have on a state ratable take order. That effect was considered thirteen years later in *Northern Natural,* which was decided after the 1954 decision in *Phillips.*

Phillips

At the time *Peerless* was decided, the NGA had not been construed to apply to the first sale transaction between a producer and an interstate gas purchaser. Four (4) years later, however, the Court's decision in *Phillips Petroleum Co.* v. *Wisconsin,* 347 U.S. 672 (1954) extended the NGA, and the FPC's jurisdiction thereunder, to cover a producer's sale of gas to an interstate pipeline, thus allowing the FPC to determine, *inter alia,* whether gas could be sold into interstate commerce and whether the sales price was "just and reasonable." Distinguishing *Peerless,* the Court reiterated the aim of the NGA:

> "Protection of consumers against exploitation at the hands of natural-gas companies was the primary aim of the Natural Gas Act. * * *"

347 U.S. at 685.

Phillips launched a twenty-five (25) year period during which the FPC (later FERC) under Section 1(b) of the NGA, controlled all facets of producers' sales and interstate pipelines' purchases of gas. The "red tape" was so burdensome and the "just and reasonable" prices set by the FPC were so artificially low that, as the years passed by, the prices provided little or no incentive for producers to develop new gas reserves and sell that gas into the interstate market. The "pay-off" for this scheme of federal regulation was a severe shortage of gas on the federally-regulated interstate market, while the *state*-regulated intrastate market enjoyed an abundance of gas.

Northern Natural

Northern Natural was an extension of *Phillips'* holding that wellhead sales of gas in interstate commerce were within the scope of § 1(b) of the NGA, and *Phillips'* philosophy that consumers should be protected from higher gas prices. The Court, with Harlan, Stewart and Goldberg dissenting, and White, not participating, held invalid a ratable take order which the Kansas Corporation Commission entered against an interstate pipeline company, because the state order invaded what was *then* the FPC's exclusive regulatory jurisdiction under Section 1(b) of the Natural Gas Act of 1938 (NGA):

> "We disagree with the Kansas Supreme Court, for we hold that the State Commission's order did invade the exclusive jurisdiction which the Natural Gas Act has conferred upon the Federal Power Commission over the sale and transportation of natural gas in interstate commerce for resale."

372 U.S. at 89. The limited statutory basis for the result in *Northern Natural* is evidenced by the fact that the Court was careful to point out that it was not overruling *Peerless.*[12] Thus, the state order was invalidated on a narrow statutory ground because of the "imminent possibility of conflict" with the FPC's then existing exclusive jurisdiction[13] under Section 1(b) of the NGA, *inter alia,*

---

[12] 372 U.S. at 91, note 10. Peerless was most recently cited in a NGPA context in *Energy Reserves Group, Inc.* v. *Kansas Power & Light Co.*, 459 U.S. 400 (1983). There, the Court cited *Peerless* for its holding that a state has the power to regulate natural gas prices and sales so long as that regulation does not interfere with the Commerce Clause. *Id.* at notes 16 & 17. Other decisions have reaffirmed the continuing validity of *Peerless. See, e.g. Sporhase* v. *Nebraska,* 458 U.S. 941, n. 16 (1982); *Cities Service Co.* v. *FEA,* 529 F.2d 1016, 1027 (T.E.C.A. 1975); *Chevron Chemical Co.* v. *Castle,* 641 F.2d 104, 116 (3rd Cir. 1981).

[13] The Court in *Northern Natural* stated that with respect to the NGA, "[t]he Congress enacted a comprehensive scheme of fed-

to grant or deny the entry of gas into the interstate market, and to fix the "just and reasonable" wellhead sale price of that gas. It was precisely that jurisdiction which was eliminated by NGPA Section 601(a)(1).[14]

The NGPA

To represent that the NGPA merely extended federal regulation to all gas in order to "totally regulate" the natural gas industry is to seriously distort the expressed meaning and intent of the NGPA, and is to give the Court no idea of why federal regulation was initially extended and for what ultimate purpose. To answer those questions is to supply the reasons why Section 601(a)(1) was included in the NGPA and why the State may now attach the ratable take requirement at issue to *any* purchaser's takes of federally deregulated gas.

---

eral regulation of 'all wholesales of natural gas in interstate commerce, whether by a pipeline company or not and whether occurring before, during, or after transmission by an interstate pipeline company,' " 372 U.S. at 91. Compare that pre-NGPA view with the Court's post-NGPA view of the scheme of federal regulation, stated in *Public Service Commission* v. *Mid-Louisiana Gas Co.*, 463 U.S. 319 (1983):

> "The NGPA is designed to preserve the Commission's authority under the NGA to regulate natural gas sales from pipelines to their customers; however, *it is designed to supplant the Commission's authority to establish rates for the wholesale market, the market consisting of so-called 'first-sales' of natural gas.*" [Emphasis added].

[14] In *Northern Natural*, the Court also noted that "[p]ersistent efforts to narrow the scope of the broader exclusive federal jurisdiction conferred by the [NGA] have been unavailing." 372 U.S. at 91, note 9. Those efforts continued, however, and ultimately culminated in passage of the NGPA and the inclusion of § 601 therein which altogether eliminated FERC's jurisdiction under the NGA over the first sale of certain categories of natural gas, such as § 107 gas.

The purpose of the NGPA was not to extend federal regulation for the simply joy of regulating nor to ensure a supply of "cheap gas." The NGA policy of regulation-for-cheap gas ultimately led to the severe shortages of gas in the interstate market in the 1970s which in turn prompted passage of the NGPA as a solution to those shortages.

Why Did Congress Include Section 601 in the NGPA?

The NGPA in general, and Section 601 in particular, was enacted in large part to eliminate those NGA regulatory features which had actively discouraged producers from selling new gas into the interstate market and had seriously handicapped interstate pipeline purchasers, like Transco, in their attempts in the late 1970s to purchase new gas for the interstate market to meet the then serious shortfall of gas in that market.

Prior to the enactment of the NGPA, two NGPA regulatory features actively discouraged producers from selling new supplies of natural gas into interstate commerce: (1) The literal regulatory maze which a producer and a pipeline had to go through and comply with before a pipeline could even purchase gas for the interstate market, and (2) extremely low NGA-mandated and FERC-determined "just and reasonable" ceiling prices which a pipeline could pay a producer for gas.

The extent of the FERC's pre-NGPA *total* control over all aspects of the producer/pipeline sale and purchase of gas can be appreciated by an examination of the FERC's pre-NGPA/NGA-power to grant or deny a certificate of public convenience and necessity. Under the NGA, gas could not even lawfully enter the interstate market unless the FERC first issued a certificate of public convenience and necessity. The FERC would not issue the required certificate unless the producer-pipeline contract contained certain price limitation clauses and excluded other types

of clauses.[15] Thus, through its power to grant or deny the required certificate of public convenience and necessity, the FERC was able to *directly* dictate the contract terms and price which a pipeline could pay and a producer could receive.

It was because of these discouraging features of the NGA and the FERC's regulatory powers under the NGA that producers began selling their gas in the intrastate market (they didn't have to deal with the NGA or the FERC, and they could get a much higher price) and, concomitantly, pipelines like Transco were unable to purchase gas for the interstate market. By the late 1970s, the "cause and effect" finally culminated in severe gas shortages in the interstate market, while at the same time there existed an abundance of higher priced gas in the intrastate market. That "national problem" of gas shortages in the interstate market was *the* reason why Congress passed the NGPA.[16]

In enacting the NGPA, Congress had two central goals: First, to provide price incentives to producers to drill more gas wells, find new gas and put that new gas into the interstate market. Second, to free producers and pipelines

---

[15] *See, e.g.*, 18 C.F.R. Sections 154.39 and 154.103. *See also* the "Curtis/Jackson Letter" of September 8, 1978 which appears as part of the legislative history of the NGPA: "At present, the Commission's existing certification procedures entail an examination of whether the proposed contract conforms with the Commission's price regulations. As a result of this review, the Commission's certificate is typically conditioned to eliminate or modify contractual provisions which would operate to yield a price in excess of that demand just and reasonable . . . . [T]he NGA authorization for these controls would cease under the NGPA . . . ." Federal Programs Advisory Service [FPAS] § 601:220, pg. 3.

[16] *See, e.g., Tenneco, Inc.* v. *Sutton, supra*, 530 F.Supp. at 418, notes 24 & 25, at 420-21; *Mid-Louisiana Gas Co.* v. *FERC*, 664 F.2d 530, 533 (5th Cir. 1982); *Pennzoil Co.* v. *FERC, supra*, 645 F.2d at 367, n. 13.

from those regulatory features of the NGA and the FERC's jurisdiction which were discouraging producers from selling gas to the pipelines and were crippling pipelines' ability to purchase new gas.[17]

Those congressional goals were reached by Congress first, extending federal regulation to intrastate gas in order to eliminate the price discrepancies then existing between the intrastate and interstate markets; second, eliminating the FERC's NGA-jurisdiction and powers to require a producer and a pipeline to obtain the FERC's approval of the entry of new gas into the interstate market and the price to be paid by the pipeline for that gas; and third, enacting fairly immediate price deregulation for some new gas ("high-cost gas" under Section 107), and gradual price deregulation for other new gas (such as gas under Sections 102 and 103). Sections 121 and 601 of the NGPA accomplished the later two of these goals.

Section 121 provided producers with the price incentives needed to encourage them to find new gas and sell that gas into the interstate market. Thus, Section 121 eliminated price controls for Section 107 "high-cost gas" (as of November 1, 1979) and set a January 1, 1985 date for price deregulation of other new gas, such as gas qualifying under Sections 102 and 103. Section 121 thus furnished *the price incentives* which Congress intended.

Section 601 provided producers and pipelines with the freedom from regulatory interference by the FERC with a pipeline's purchase and a producer's sale of new gas

---

[17] *See, e.g., Pennzoil Co.* v. *FERC*, 645 F.2d at 378: "The NGPA is a fundamental change in regulatory outlook. * * * FERC has a fundamentally different regulatory obligation. . . . The balance Congress struck already took into account the conflicting interests of producers and consumers." In *Pennzoil*, the Court concluded that the effect of § 601(a)(1)(A) was to deny FERC the authority to regulate or interpret gas purchase contracts covering "undedicated" gas. *Id.* at 380. *See also Mid-Louisiana Gas Co.* v. *FERC*, 664 F.2d at 530, 535 (5th Cir. 1981); Williams, *supra*, note 5.

in order to enable a pipeline to freely compete for new gas by allowing the pipeline to pay a producer the higher incentive prices or deregulated prices for new gas (without *ever* having to get FERC approval of the prices paid or the other terms of the contract), and to exempt a pipeline and a producer alike from the then existing regulatory constraints of the NGA and the FERC's jurisdiction under the NGA, constraints which had combined with low FERC-set "just and reasonable" prices to produce the severe gas shortages of the late 1970s caused by the producers' reluctance (and sometimes refusal) to sell their gas to interstate commerce, and the pipelines' inability to buy new gas from the producers. Section 601 thus furnished the pipelines and the producers with *the degree of freedom from regulatory interference* by the FERC which Congress intended.[18]

Section 601(a)(1)

We will not mince words: If the "first sale" (the well-head sale) of deregulated gas[19] continues to be subject to

---

[18] *See, e.g., Tenneco* v. *Sutton*, 530 F.Supp. 411, 419 (M.D. 1981): "These provisions [Section 601] remove the Commission's authority to establish just and reasonable prices under the NGA for producer sales into the interstate market and to indirectly regulate these sales through control of the interstate pipeline purchaser's pass-through of purchase gas costs." *See also* the "Curtis/Jackson Letter", FPAS § 601:220 (9-8-78), on Section 601: "This section [601] executes the legislative intent to remove from Natural Gas Act utility type regulation natural gas not heretofore dedicated or committed to interstate commerce (§ 601(1)(1)(A), and to remove from Natural Gas Act-type regulation heretofore jurisdictional sales of high cost gas, gas from new OCS leases, new well qualifying for the new natural gas price under section 102, and [103 gas] (§ 601(a)(1)(B)." FPAS § 601:220, page 2.

[19] The gas in question is both *deregulated gas* (meaning that it has been classified as "deep, high-cost gas" under NGPA Section 107(c)(1) and *undedicated gas* (meaning that it was not committed or dedicated to interstate commerce as of the day before the date of the enactment of the NGPA).

the FERC's jurisdiction under Section 1(b) of the NGA, then *Northern Natural* applies to this case and Order No. 409-82 is invalid. However, if the FERC's jurisdiction under Section 1(b) of the NGA no longer applies to the first sale of deregulated gas, then *Northern Natural* cannot apply to this case and Order No. 409-72 is as valid and enforceable as was the same type of state order in *Peerless*.

Clearly, under NGPA § 601(a)(1)(A) and (B), the first sale and purchase of deregulated gas is no longer subject to either the NGA or the FERC's NGA jurisdiction. Congress has specifically declared that the first sale of deregulated gas is *never* made subject to the NGA or the FERC's jurisdiction under the NGA, and "dedicated gas" which is determined to be also deregulated gas *ceases* to be subject to the NGA and the FERC's jurisdiction under the NGA.

NGPA Section 601(a)(1)(A), (B) and (D), 15 U.S.C. § 3431(a)(1)(A), (B) and (D), provide as follows:

> SECTION 601. COORDINATION WITH THE NATURAL GAS ACT—
>
> (a) JURISDICTION OF THE COMMISSION UNDER THE NATURAL GAS ACT.—
>
> (1) SALES.—
>
> (A) NATURAL GAS NOT COMMITTED OR DEDICATED—
>
> *For purposes of section 1(b) of the Natural Gas Act*, effective on the first day of the first month beginning after the date of the enactment of this Act, *the provisions of the Natural Gas Act and the jurisdiction of the Commission under such shall not apply to natural gas which was not committed or dedicated to interstate commerce as of the day before the date of the enactment of this Act* solely by reason of any first sale of such natural gas.

(B) COMMITTED OR DEDICATED NATURAL GAS—

Effective beginning on the first day of the first month beginning after the date of the enactment of this Act, *for purposes of section 1(b) of the Natural Gas Act, the provisions of such Act and the jurisdiction of the Commission under such Act shall not apply solely by reason of any first sale of natural gas which is committed or dedicated to interstate commerce as of the day before the date of the enactment of this Act and which is—*

(1) *High-cost natural gas* (as defined in Section 107(c)(1), (2), (3), or (4) of this Act);

• • •

(D) NATURAL GAS COMPANY—For purposes of the Natural Gas Act, the term "natural gas comapny" (as defined in section 2(6) of such act) *shall not include any person by reason of, or with respect to, any sale of natural gas if the provisions of the Natural Gas Act and the jurisdiction of the Commission do not apply to such sale solely by reason of subparagraph (A), (B) or (C) of this paragraph.* [Emphasis added].

The "Joint Explanatory Statement of the Committee on Conference" of the Congress, which accompanied the NGPA, is extremely important because it states in plain English what Section 601(a)(1) means:

"The conference agreement limits the jurisdiction of the Commission under the Natural Gas Act in a manner similar to the House-passed bill.

Natural gas not committed or dedicated to interstate commerce as of the day before the date of the enactment of this Act is never made subject to the Commission's jurisdiction under sec. 1(b) of the Natural Gas Act. The Commission's jurisdiction under section 1(b) of the Natural Gas Act ceases on the first day of the first month beginning after the date of enactment of this Act for the following categories of natural gas:

> *High-cost natural gas* which qualifies for deregulated price treatment under the section 107(c)(1), (2), (3), or (4); [Emphasis added].

Section 601(a)(1) means what it says—the Natural Gas Act of 1938 (NGA) and FERC's jurisdiction under the Act *never* apply to deregulated gas, and certain other categories of gas.[20]

Analysis of Section 601

Under the Section 601 statutory scheme,[21] Section 601 (a)(1) removes the FERC's NGA-jurisdiction to directly or indirectly control or regulate a pipeline's purchase of deregulated gas and the price paid by the pipeline for that

---

[20] *See Pennzoil Co.* v. *FERC,* 645 F.2d 360, 380 (5th Cir. 1981): "NGPA § 601(a)(1)(A) further provides that gas which on November 8, 1978, was not committed or dedicated to interstate commerce is exempt from NGA jurisdiction effective December 1, 1978, even if it is therefore sold in interstate commerce. *In other words, section 601(a)(1)(A) prevents the universe of gas subject to the NGA from expanding.*" [Emphasis added] The court held that, because of Section 601(a)(1)(A), FERC never has jurisdiction to regulate or interpret gas purchase contracts covering undedicated gas.

[21] *See, e.g., Tenneco, Inc.* v. *Sutton, supra,* 530 F.Supp. at 419: "These provisions [Section 601] remove the Commission's authority to establish just and reasonable prices under the NGA for producer sales into the interstate market and to indirectly regulate these sales through control of the interstate pipeline purchaser's pass-through of purchase gas costs." *See also* the "Curtis/Jackson Letter", *supra,* on Section 601: "This section [601] executes the legislature intent to remove from Natural Gas Act utility type regulation natural gas not heretofore dedicated or committed to interstate commerce (§ 601(a)(1)(A), and to remove from Natural Gas Act-type regulation heretofore jurisdictional sales of high cost gas, gas from new OCS leases, new well qualifying for the new natural gas price under Section 102, and [103 gas] 601(a)(1)(B)." FPAS 601: 220, page 2.

gas. In place of that "lost" jurisdiction over the pipeline's purchases of that gas, Section 601(c) gives the FERC the jurisdiction and power to deny a pipeline pass-through of the price the pipeline pays for deregulated gas, but *only* if the FERC can prove that the price results from "fraud, abuse or similar grounds." Moreover, the FERC's power to deny a pipeline a pass-through can be exercised *only* against the pipeline and *only* when (and if) the pipeline comes before the FERC to obtain authority to pass-through the entire price paid by the pipeline and include that price in the resale rates charged by the pipeline to consumers. However, the FERC still has no authority or jurisdiction (not even under Section 601(c)) to regulate or control a pipeline's purchase of deregulated gas, or the price which the pipeline pays to producers or the pipeline's contract with the producers.

Our inquiry into "why did Congress include Section 601" merits a brief sub-section by sub-section analysis of just how Congress used Section 601 to free the producers and pipelines from the NGA and FERC's NGA-jurisdiction to control purchases, sales, contract terms and prices paid by pipelines for deregulated gas.

First, Congress included Section 601(a)(1) to eliminate the NGA requirement that the parties had to first obtain from the FERC a certificate of public convenience and necessity as to new gas, and to remove the FERC's jurisdiction and power to set a "just and reasonable" price and dictate contract terms. Section 601(a)(1) provides that the first sale of undedicated gas is never made subject to the NGA or the FERC's NGA-jurisdiction.[22] The *effect* of this particular sub-section is that neither the producer nor the pipeline ever has to obtain the previously required certificate of public convenience and necessity in order to

---

[22] NGPA § 601(a)(1)(A)(B), 15 U.S.C. § 3431; Joint Explanatory Statement of the Committee on Conference of the Congress. *Accord, Pennzoil Co.* v. *FERC, supra,* 645 F.2d at 380.

sell and buy this type of new gas.[23] Because the parties do not have to obtain a certificate from the FERC, the FERC cannot use its NGA power (to grant or deny a certificate) to control purchases, contract terms and price, as it did prior to enactment of the NGPA.[24] Nor can the FERC, pursuant to its NGA jurisdiction over a "natural gas company," control the price which a pipeline like Transco pays for the gas on the grounds that Transco is an otherwise regulated "natural gas company." Section 601(a)(1)(D) takes care of that potential problem by providing that Transco shall not be considered to be a "natural gas company" with respect to its purchase of deregulated gas.

Second, Congress included Section 601(b) and (c) to protect a pipeline from an after-the-purchase attack by

---

[23] *See, e.g., Conoco, Inc.* v. *FERC*, 622 F.2d 796 (5th Cir. 1980). *See also* FERC's Preamble to the issuance of the first interim regulations issued after the NGPA was passed, 43 F.R. 56448 (12-1-78), wherein FERC observed the effect of the NGPA on the NGA:

> "The new law affects sales, transmission and distribution of natural gas. The previously controlling federal regulatory statute, the Natural Gas Act (NGA) has in many respects been limited, replaced or superseded by the NGPA . . . ." (*Id.* at 56451).
>
> "If gas is not committed or dedicated to interstate commerce . . . or is exempted from the jurisdiction of the NGA under section 601(a)(1)(B) as [107 or 102 or 103 gas] the prior framework of utility-type regulation under the NGA no longer applies."
>
> "If natural gas sales are freed from the requirements of the NGA, several adjuncts to NGA regulation are obviated. First, there is no longer any necessity for a producer to seek certification of the sales as serving the public convenience and necessity." *Id.* at 56455.

[24] *See, e.g., Pennzoil Co.* v. *FERC, supra*, in which the Fifth Circuit held that FERC no longer has jurisdiction to regulate or interpret gas purchase contracts covering undedicated gas or dedicated gas which is also 107 or 102 or 103 gas: "In other words, section 601(a)(1)(A) prevents the universe of gas subject to the NGA from expanding." 645 F.2d at 380.

the FERC on the price which the pipeline pays for deregulated gas. Section 601(b) provides that all prices which the pipeline pays for deregulated gas are deemed "just and reasonable" as a matter of law, and Section 601(c) provides that the pipeline has the guaranteed right to pass-through the price which it pays for deregulated gas and include that price in its resale rates charges to consumers.[25]

A pipeline can be denied its guaranteed statutory right to pass-through the price paid to producers *only* if the FERC finds that the price results from "fraud, abuse or similar grounds." *See* Section 601(c)(2). That particular determination can be made *only* in rate proceedings before the FERC in which the pipeline seeks authority to pass-through the deregulated price and include the price in its resale rates to consumers. The FERC can deny the pipeline a pass-through of *only* that portion of the deregulated price which results from "fraud, abuse or similar grounds." However, the FERC still has no jurisdiction or authority to prevent the pipeline from purchasing deregulated gas or paying deregulated prices to the producers.[26]

The practical effect of Section 601(a)(1) is that the FERC cannot prevent, regulate or control a pipeline's purchases and takes of deregulated gas nor the price which the pipeline pays for that gas; the FERC cannot directly or indirectly regulate, control or dictate the contractual

---

[25] *See, e.g., Pennzoil Co.* v. *FERC*, 645 F.2d 360, 379 (5th Cir.): "Section 601(c)(2) guarantees to interstate pipelines the ability to pass through NGPA payments." *See also* FERC's preamble to its interim regulations under the NGPA, 43 F.R. 56448, 56456 (12-1-78).

[26] In this regard, many contracts in industry use for years provide that, if FERC denies a pipeline the right to pass-through all or part of the contract price, that denial gives the purchaser the right to cancel the contract. But the pipeline may elect to keep the contract in effect by continuing to pay the contract price even though the pipeline is not able to pass-through the entire contract price in its resale rates.

terms on which the gas is to be sold and purchased; the pipeline and the producer do not ever have to obtain the FERC's approval of the price paid by the pipeline; and the pipeline and the producer do not ever have to obtain a certificate of public convenience and necessity from the FERC in order for the pipeline to be able to buy the gas and bring it into the interstate market.

Section 601(a)(1), therefore, is controlling of the preemption question in this case. The reason this Court voided the ratable take order in *Northern Natural* was because at that particular point in time such an order was perceived to substantially affect an area (wellhead sales) which was subject to the FPC's jurisdiction under the NGA. If the NGA and the FERC's jurisdiction under the NGA no longer apply to the wellhead sale and purchase of deregulated gas, and the FERC has no authority to regulate the first sale and purchase of deregulated gas, either directly or indirectly, then *Northern Natural* does not preempt the otherwise existing authority which the States have to require a gas purchaser to offer to take gas ratably and, in the absence of an agreement, pay a market price. *Peerless.*

3.

There Is No Conflict Between Mississippi's Ratable Take Requirement and the NGA/NGPA

Obviously, the NGPA regulatory scheme is vastly different from the NGA regulatory scheme which prevailed when *Northern Natural* was decided. There *now* is neither an actual nor a hypothetical conflict between the state ratable take requirement at issue and, on the other hand, the NGA and the NGPA.

To review, at the time *Northern Natural* was decided the FPC (now FERC) had two fundamental regulatory powers over gas which was destined for an interstate market. First, before the gas could even enter the interstate market, the producer and pipeline had to obtain a

certificate of public convenience and necessity from the FPC; they were not free to simply put the gas into the interstate market without FPC approval. Second, the price paid by the pipeline had to be first approved by the FPC as a "just and reasonable price"; the producer and pipeline were not free to negotiate a price. There were no ceiling prices as such, only "just and reasonable" prices, and there was no interstate gas which was not subject to federal price regulation.

That was the federal regulatory scheme with which the Kansas ratable take/minimum price order collided in *Northern Natural*. The order could interfere with *both* of what were *then* the FPC's fundamental regulatory powers because the order could force gas into interstate commerce, without a *then* required certificate of public convenience and necessity, and set a minimum price to be paid for the gas, without a *then* required adjudication by the FPC that the minimum price was "just and reasonable."

The NGPA fundamentally changed that regulatory scheme. First, a certificate of public convenience and necessity is no longer required before undedicated or deregulated gas can enter the interstate market; a producer and pipeline are free to put the gas into the interstate market at anytime. This, of course, is consistent with the overall goal of the NGPA—to get *more* gas into interstate commerce with less red tape. Second, the FERC has no jurisdiction over and no authority to set the "first sale" price to be paid by the pipeline for deregulated gas; under Section 601(b)(1)(A) the price paid by the pipeline for deregulated gas is presumed to be "just and reasonable" and no FERC approval is required before the pipeline can pay that price. Nor can the FERC seek to influence or affect the first sale price paid by the pipeline through the FERC's jurisdiction over the pipeline's resale rates; under Section 601(c), the pipeline has a guaranteed statutory pass-through of the price it pays for the gas, unless the price results from "fraud, abuse or similar grounds."

Thus, the state action at issue stops short of affecting any transaction which continues to be subject to the NGA and FERC's jurisdiction thereunder. The ratable take requirement affects only the first sale—it goes no further. It is a case of congruent state and federal regulation.[27] Where one stops the other starts and neither infringes upon the other. Thus, the State is free, once again, to attach the ratable take requirement at issue to an interstate pipeline's takes of federally-deregulated gas. *Peerless.*

Transco's efforts to equate Mississippi's ratable take requirement with the state action which was invalidated in *Maryland* v. *Louisiana,* 451 U.S. 725, 101 S.Ct. 2114 (1981), and in *Exxon Corp.* v. *Eagerton,* 103 S.Ct. 2296 (1983), is sophistry. Generically, those cases are "preemption cases," but they have *nothing* to do with deregulated gas, or, more importantly, Section 601(a)(1).

In *Maryland* v. *Louisiana,* Louisiana's "First Use Tax" provided for a tax on the first use of natural gas imported into Louisiana which was not previously taxed by another State or by the United States. The tax was designed to apply to gas produced off-shore from Louisiana and brought into the state. Louisiana law provided that the amount of the tax was to be deemed a "cost associated with uses made by the owner in preparation of marketing the gas" and further required that the tax must be born by either the owner of the gas or by the ultimate consumer. The Supreme Court held that the tax violated the NGA because the NGA gave the FERC the authority to determine the proper *allocation* of costs associated with the sale of natural gas to consumers and the Louisiana law directly inferfered with that authority because it attempted to dictate *to whom* the use tax would be *allocated.* The point: The NGA did apply to that gas and the Louisiana "First Use Tax" directly conflicted with the FERC's authority under the NGA to allocate costs in setting the resale price of gas sold in interstate commerce. *Maryland*

---

[27] *See,* Williams, *supra,* note 5.

v. *Louisiana* simply has no application to the particular federal preemption question now before this Court.

Exxon v. *Eagertown, supra,* was simply *Maryland* v. *Louisiana* with a twist. After the NGPA was passed, Alabama increased its severance tax on gas but prohibited producers from passing the tax increase through to consumers. The Supreme Court, citing *Maryland,* struck down the prohibition on the pass-through because it also "interfere[d] with the FERC's authority to regulate the determination of the proper allocation of costs associated with the sale of natural gas to consumers." 103 S.Ct. at 2303. In other words, the Alabama statute directly conflicted with the FERC's NGA authority to allocate costs in the *resale* of gas in interstate commerce.

Recent Supreme Court cases are more instructive of the power of the States to regulate against a background of federal regulation. In *Energy Reserves Group, Inc.* v. *Kansas Power & Light Co., supra,* an NGPA case, the Court upheld a state law providing for lower than maximum NGPA prices, citing *Peerless* for the proposition that the States could regulate natural gas prices provided they did not interfere with interstate commerce. 103 S.Ct. at 706, n. 16. In *Arkansas Electric Cooperative Corp., supra,* the Court held that the Arkansas commission's assertion of jurisdiction over the wholesale electric rates of a cooperative was not preempted by the Federal Power Act or the Rural Electrification Act. In *Pacific Gas & Electric Co., supra,* the Court upheld a state law which conditioned the construction of nuclear power plants on state funding of the availability of adequate storage facilities and means of disposal. *See also* the recent decisions in *Hillsborough County* v. *Automated Medical Laboratories, Inc.,* 53 L.W. 4612 (June 4, 1985), and *Metropolitan Life Insurance Co.* v. *Commonwealth,* 53 L.W. 4616 (June 4, 1985), upholding state and local regulatory acts carried out against a background of federal regulation.

In all of these recent cases, the Court refused to find state action preempted on the basis of mere hypothetical possibilities advanced by counsel. *Arkansas Electric Cooperative Corp., supra,* 103 S.Ct. at 1918; *Pacific Gas & Electric Co., supra,* 103 S.Ct. at 1729-30, 1731-32. That, of course, was precisely what Justice Harlan argued in his dissent in *Northern Natural.* 372 U.S. at 103-106.

Moreover, Mississippi's requirement does not frustrate or stand as an obstacle to the purposes and objectives of the NGPA. The overriding objective of the NGPA is to make more new gas available for sale in the interstate market at market prices. Mississippi's requirement fits congruently with that objective because it affords all of the owners of federally-deregulated gas in a pool the opportunity to offer their gas for sale in interstate commerce at a market price. The requirement nurtures the development of a competitive wellhead market and lower—not higher—market prices by affording more producers access to the market. Thus, more competition at the wellhead is the practical result.

Finally, in an attempt to bolster its claim of an actual conflict between Mississippi's ratable take requirement and the FERC's jurisdiction, Transco represents that the FERC has opened an "inquiry on possible discrimination of interstate pipelines in their purchasing practices." Transco's Brief at page 33. The FERC's silence on this point is deafening—the FERC's Brief does not so much as even mention the "inquiry," which is not even shown on the FERC's Semiannual Regulatory Agenda as being under consideration. *See* 49 F.R. 42418 (10-22-84). In fact, aside from one public meeting held two years ago, the FERC has not taken any further action in the docket, obviously because the FERC does not have any jurisdiction to directly or indirectly regulate an interstate pipeline's purchases and takes of deregulated gas in a first sale transaction.[28]

---

[28] In a related controversy, the FERC has declined to act on

II.

MISSISSIPPI'S RATABLE TAKE REQUIREMENT DOES NOT VIOLATE THE COMMERCE CLAUSE

Mississippi's ratable take requirement does not violate the Commerce Clause. First, the requirement effectuates legitimate state interests in protecting the coequal and correlative rights of the owners in a pool, affording each owner the opportunity to recover and sell his just and equitable share of gas from the pool, and treating the owners fairly. Second, the requirement applies evenhandedly to anyone who takes gas from a gas pool. Economic protectionism is neither the purpose nor the practical effect of the requirement. Third, whatever burden might be imposed on interstate commerce as a result of the requirement is incidental, if it exists at all.

This Court has held that a state ratable take/minimum price order entered against an interstate gas purchaser does not violate the Commerce Clause. *Peerless. Northern Natural* was careful to point out that *Peerless* remained good law. More importantly, however, since *Peerless* was decided this Court has formulated a new Commerce Clause test which has accorded the States a wider berth.

The modern Commerce Clause test is the balancing-of-interests test articulated in *Pike* v. *Bruce Church, Inc.*, 397 U.S. 137 (1970):

---

various pipelines' requests for relief from contractual price and take-or-pay obligations which the pipelines, in hindsight, view as "uneconomic." The FERC has also told the Fifth Circuit that breach of contract suits brought by producers against their pipeline purchasers should not be referred to the FERC because FERC has yet to decide what, if any, jurisdiction it has over pipeline purchasing practices. *See In re Tenneco, Inc.*, No. 84-4074, Opening Brief of the FERC, submitted April 10, 1984. *See also* Moring, *A Quiet Revolution? The FERC Yields Pipeline Jurisdiction to the States and Courts*, Public Utilities Fortnightly at 36 (11-22-84).

> "[W]here [a] statute [regulation, rule or order] regulates evenhandedly to effectuate a legitimate local public interest, and its effects on interstate commerce are only incidental, it will be upheld unless the burden imposed on such commerce is clearly excessive in relation to the putative local benefits. • • • If a legitimate local purpose is found, then the question becomes one of degree. And the extent of the burden that will be tolerated will of course depend on the nature of the local interest involved, and on whether it could be promoted as well with a lesser impact on interstate activities."

397 U.S. at 142.

This modern test stands in stark contrast to the old, mechanical "bright line" test drawn in *Public Utilities Commission* v. *Attleboro Steam and Electric Co.*, 273 U.S. 83 (1927), and its predecessor cases, *Missouri* v. *Kansas Gas Co.*, 265 U.S. 298 (1924) and *Public Utilities Commission* v. *Landon*, 249 U.S. 236 (1919). The *Attleboro* test was, for all practical purposes, repudiated by this Court during its 1983 term:

> "We are faced, then, in this case, with precisely the question left open in *Illinois Gas:* Do we follow the mechanical test set out in *Attleboro*, or the balance-of-interests test applied in our Commerce Clause cases for roughly the last 45 years? • • • Thus, in recent years, this Court has explicitly abandoned a series of formalistic distinctions—akin to the one in *Attleboro*—which once both defined and controlled various corners of the Commerce Clause Doctrine. • • •
>
> The wholesale/retail line drawn in *Attleboro* is no less anachronistic than the rules we rejected in the cited cases. Moreover, we have had no occasion, since the 1930s, either to apply that line or to reject it in a case not governed by statute. The difficulty of harmonizing *Attleboro* with modern Commerce Clause doctrine has been apparent for a long time, so much so that we expressed skepticism about its continuing soundness as a constitutional, rather than statutory, rule in *Illinois Gas.*"

Arkansas Electric Cooperative Corp. v. *Arkansas Public Commission, supra,* —— U.S. at ——, 103 S.Ct. at 19160.

In recent years, the new balancing test under the Commerce Clause has been applied to accord the States a wider berth and uphold a wider variety of state regulatory activities which have been carried out against a background of federal regulation. *See* e.g., *Arkansas Electric Cooperative Corp.* v. *Arkansas Public Commission, supra* (state commission could govern wholesale electric rates); *Minnesota* v. *Cloverleaf Creamery Co.,* 449 U.S. 456, 471-73 (1981) (state could ban sale of milk in plastic containers); *Reeves, Inc.* v. *Stake,* 447 U.S. 429, 443-47 (1980) (state could limit sale of state-controlled cement to residents); *Exxon Corp.* v. *Governor of Maryland,* 437 U.S. 117, 127-29 (1978) (state could mandate that oil producers not own retail outlets). *See also Commonwealth Edison* v. *Montana,* 453 U.S. 609, 624-29 (1981) (state could place exorbitant severance tax on coal); *Complete Auto Transist Co.* v. *Brady,* 430 U.S. 274, 288-89 (1977) (upholding a tax imposed by the state against an interstate trucking company for the privilege of doing business within the state).

1.

The Legitimate State Interests Supporting the Ratable Take Requirement

The interests sought to be effectuated by Mississippi's ratable take requirement have been reviewed and discussed at length earlier in this brief. *Supra* at pages 6-10, 14-15. These interests are undeniably legitimate and important.

2.

The Ratable Take Requirement Applies Evenhandedly

The uneven and discriminatory application of a state statute, order or regulation can be a form of economic pro-

tectionism. In *Arkansas Electric Cooperative Corporation, supra,* this Court identified economic protectionism as the most serious concern identified in *Pike.* Economic protectionism, however, is neither the purpose nor the practical effect of Mississippi's ratable take requirement.

Mississippi's ratable take requirement applies to *anyone* who purchases gas from a pool, whether a corporation or an individual, whether the purchaser hails from within or outside of Mississippi, and whether the purchaser is interstate or intrastate in character. Moreover, the requirement does not discriminate in favor of Mississippi production nor does it give Mississippi producers a larger share of any market. The requirement does not force or require Transco to take any set quantities of gas nor, for that matter, any gas at all. Transco, taking into consideration its market needs is free on even an ***hourly*** basis to take 100% of a pool's allowable, or 10%, or 1%, or none at all. All the State has required is that Transco offer to take *whatever* quantities of gas *Transco* decides it needs ratably from the wells producing from the pool.

The "practical effects" Transco and the FERC have dreamed up for purposes of their briefs are purely hypothetical possibilities which are not supported by any evidence in the record, nor by common sense. For example, Transco represents that "the practical result will be a significant increase in Mississippi purchases with a significant decrease in Transco's purchases from other states." (Transco's brief at page 39). Yet, there is not one word of evidence in the record to support this claim. There is no evidence of what additional quantities of gas, if any, Transco would have to take because of Mississippi's requirement, or whether that gas would displace any gas purchased outside of Mississippi. There is no evidence that Transco would have to take any greater quantities of gas from Mississippi as opposed to other states. It is just as

likely that now, as always, Transco takes more gas from other states than from Mississippi. Finally, there is no evidence that Transco has been prevented from taking less expensive gas because of Mississippi's requirement. Indeed, the irony of Transco's position is that the gas which Transco takes under Mississippi's ratable take requirement will be *less expensive* than the gas Transco wants to take under its contracts with the likes of Getty and Florida Exploration. The highly speculative nature of these alleged "practical effects" is underscored by the fact that since December 1982 Transco has continued to ratably take gas from the pool in question and pay a "market-out" price for the non-contract owners' gas.

All of this is to say that the burden created by Mississippi's ratable take requirement, if any, is not a burden on interstate commerce, but may be a burden on Transco. The ridiculous "practical effects" alleged by Transco are mere red herrings which have been dropped in order to divert the Court's attention from the fact that the only possible burden resulting from Mississippi's ratable take requirement is that Transco, because of some few contracts it freely agreed to with some few producers, possibly might have to reduce its takes of some of those producers' gas for an undetermined period of time, and might then incur an undetermined amount of contingent liability to make refundable take-or-pay payments to those few producers.

The speculative and isolated nature of any burden on Transco that might be an incident of Mississippi's requirement is revealed in Transco's framing of the Commerce Clause "question" in this case:

> "Does Mississippi's attempted regulation of interstate pipeline companies' purchase of "high-cost" gas constitute an impermissible burden on interstate commerce *under present market conditions?*" [Emphasis added]

This, of course, is a "weather vane approach" to the Commerce Clause: If the forecast is that compliance with

the state requirement might result in any kind of economic burden for Transco, then the requirement suddenly rises to the level of an excessive burden on interstate commerce. On the other hand, if there is no economic burden or risk for Transco, then there is no burden on interstate commerce. These type of individualized and seasonal burdens, however, are not what the Commerce Clause prescribes. Transco's fickle characterization of the Commerce Clause question in this case is directly attributable to the fact that, but for the temporary reduced demand for gas and those relatively few of Transco's gas purchase contracts in which Transco agreed to pay two or three times the market price for some gas and to make what it now regards as excessive take-or-pay payments, all without the protection of a market out clause, it would be convenient for Transco to comply with the State's ratable take requirement at issue. To paraphrase, there would be no burden on interstate commerce if Transco's "present market conditions" were "better." To indulge Transco's claim is to condition the State's exercise of its police powers on the happenstance and vagaries of the marketplace or the economic miscalculations of a party. It is to make the Commerce Clause trivial.

3.

Transco's Claim of Constitutional Regulatory Alternatives

This Court has repeatedly recognized the power of the States to enforce allowable orders so as to restrict the amount of natural gas produced and, therefore, the amount of natural gas which can be sold in interstate commerce. *See, e.g., Champlin Refining Co.* v. *Corporation Commission,* 286 U.S. 210 (1932).

The reason why Transco now touts the alleged regulatory alternative of an allowable order is Transco's self-

serving belief that Transco could wield such an order as a weapon to escape its contractual take-or-pay obligations to those producers with whom it has written contracts. As Transco candidly states in its brief:

> "A state can limit a local producer's right to produce more than his pro rata share of the available market for a common pool and effectively negate a purchaser's contract obligations in excess of that limit."

Transco's Brief at p. 47.

What is left unsaid by Transco is the fact that Mississippi law prohibits the State Oil and Gas Board from setting allowables according to market demand. Miss. Code Ann. § 53-1-1 states in relevant part:

> "It is not the intent nor the purpose of this law to require or permit the proration or distribution of the production of oil and gas among the fields and pools of Mississippi, on the basis of market demand. It is the intent and purpose of this law *to permit* each and every oil and gas pool in Mississippi to be produced *up to* its maximum efficient rate of production, subject to the prohibition of waste as herein defined, and further subject to the enforcement and protection of the co-equal and correlative rights of the owners of a common source of oil and gas, so that each, common owner may obtain his just and equitable share of production therefrom." [Emphasis added]

More to the point of the immediate discussion, however, Transco represents that an allowable order would be less burdensome on interstate commerce and, therefore, constitutional under the Commerce Clause. The illogic of this assertion is explained only by Transco's self-interest in trying to obtain such an order for use in attempting to escape its contractual take-or-pay obligations.

As Justice Harlan pointed out in his dissent in *Northern Natural,* an allowable order which limits the amount of

gas that can be taken by an interstate purchaser is as much of a "burden" on interstate commerce as is a ratable take order, if not a *greater* burden. The power of the States to control the amount of gas production through an allowable order which limits the amount of gas which can be produced presumes that a State can altogether curtail production, requiring a purchaser to look elsewhere to buy gas:

> "Indeed, the most direct interference with the availability of gas for interstate sale is the "allowable" order. It places a ceiling on the amount of gas that may be produced by a particular well during a given period of time and inevitably makes pipelines spread their demand among many wells. Obviously, its possible effect on cost is precisely the same as that which may be caused by a ratable order, for the two orders are merely variations of the same regulatory measure; both are designed to prevent the disproportionate taking of gas from some wells to the disadvantage of others."

372 U.S. at 104.

We strongly commend to the members of the Court a review of Justice Harlan's dissent in *Northern Natural*. His dissent has always made perfect sense, and even more so now that the wellhead sale of deregulated natural gas has been exempted from the FERC's jurisdiction under §1(b) of the NGA.

Mississippi's ratable take requirement is far less burdensome than the allowable order Transco wants. Mississippi's system of allowables sets a mere ceiling on production determined according to the maximum efficient rate of flow of the wells, and not according to a given pipeline's market demand. Once set, a well's allowable is a ceiling on production, not a floor. Transco is free to take any percent of the allowable, from 100% to zero, in order to meet its market needs. Transco can adjust its takes monthly, weekly, daily, hourly or by the minute. Transco decides how

much gas it needs and from what pools it will take gas. Transco can decide to take more gas from less expensive and older regulated pools, or any combination of takes it desires. In all of this, the State's requirement is so simple: If Transco decides to take gas from a pool of federally-deregulated natural gas, Transco must offer to take whatever quantities of gas it needs ratably from the wells and, in the absence of an agreement as to price, offer to pay a market price. That simple requirement is no burden on interstate commerce, much less an excessive burden.

Mississippi has not "interfered with the natural functioning of the market." (Transco's brief at p. 38.) What—and all—Mississippi has done is to put an end to Transco's patently unfair and ridiculously discriminatory takes of gas, in order to end the prospect of drainage, reservoir damage and abuse of the co-equal and correlative rights of the owners in a gas pool. If, by affording each owner in a pool a mere opportunity to sell his ratable share of a purchaser's gas needs at a mere market price, the State has interfered with what Transco calls the "natural functioning of the market," then it is indeed a perverse market that Transco has in mind, a market that was never envisioned by the framers of the Constitution. As Justice Jackson stated in *H. P. Hood & Sons, Inc.* v. *Dumond,* 336 U.S. 525 (1949):

> "Our system, fostered by the Commerce Clause, is that every farmer and every craftsman *shall be encouraged to produce by the certainty that he will have free access to every market in the nation,* that no home embargoes will withhold his export, and that no foreign state will by customs duties or regulations exclude them. Likewise, every consumer may look to the free competition from every producing area in the Nation to protect him from exploitation by any." [Emphasis added].

336 U.S. at 539.

CONCLUSION

Mississippi's simple ratable take requirement should be upheld because it does not actually or theoretically conflict with either the letter or the spirit of the NGA or the NGPA or the Commerce Clause. This requirement is so simple, so evenhanded, so fair, and so necessary in order to protect all owners in a pool—particularly the owners of small interests—from unratable takes, drainage and loss of their gas. What purchaser can reasonably complain about having to offer to pay a market price for whatever quantities of natural gas it needs if and when they are needed? The self-evident truths in that rhetorical question undergirth the reasonableness and constitutionality of Mississippi's ratable take requirement.

The decision of the Mississippi Supreme Court should be affirmed.

Respectfully submitted,

GLENN GATES TAYLOR
(Counsel of Record)
COPELAND, COOK, TAYLOR & BUSH
Suite 112 Capital Towers
Post Office Drawer 2132
Jackson, Mississippi 39225
(601) 354-0123

KENNETH I. FRANKS
JAMES RUSSELL TUCKER
HEIDELBERG, WOODLIFF & FRANKS
Suite 1400 Capital Towers
Jackson, Mississippi 39201
(601) 948-3800

Attorneys for Coastal Exploration, Inc.

July 19, 1985